

Review

ELECTIONS 2000 - The Beginning of the End

Mirosljub Labus

Any attempt at prognoses on electoral outcomes in Serbia is problematic. Previous efforts by public opinion survey agencies and political analysts have often faltered. Nevertheless, the political victory of Vojislav Koštunica is now indisputable, though the ruling regime is likely to maintain control in the Federal Assembly. The situation at the local level will be completely variegated. Elections will not be the end of the current regime, but will contribute to its further deterioration.

Serbian public opinion demonstrates a clear positive and rising trend in favor of Vojislav Koštunica. While public opinion surveys always carry margins of error and are subject to methodological flaws, all professional surveys consistently indicate that, at this moment, Slobodan Milošević is losing the race for the presidency of the FR Yugoslavia. Other candidates stand no chance at all. This is enough to conclude that Vojislav Koštunica is the political winner of these elections. His mighty opponent has never before been in such a position, even when he was competing with Milan Panić, the former Prime Minister.

Naturally, this does not assume that presidential elections are an accomplished fact. Many factors will influence the final result. Just to mention a few: voter turnout, electoral fraud, policy of the international community, quarrels in the opposition ranks, etc. The greater the voter turnout, the lesser the electoral fraud, the more discreet the international community, the smaller the disputes within the opposition - the greater the chances of Vojislav Koštunica. Even so, Vojislav Koštunica's chances are so great that Slobodan Milošević was definitely wrong to call early presidential elections.

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FRY Basic Economic Indicators	1999	1999	VII 2000	VII 2000	VII 2000	I-VII 2000
		1998		VI 2000	VII 1999	I-VII 1999
GDP - USD million	14,224 ^{a)}	-19.3%	...	...	...	...
Montenegro	...	...	...	...	...	...
Serbia	...	...	...	...	...	...
GDP per capita - USD	1,699 ^{a)}	-19.1%	...	...	...	...
Montenegro	...	...	...	...	...	...
Serbia	...	...	...	...	...	...
Central Serbia	...	...	...	...	...	...
Vojvodina	...	...	...	...	...	...
Industrial Production	...	-24.1%	...	-5.3%	24.3%	20.0%
Montenegro	...	-7.6%	...	14.4%	14.6%	1.0%
Serbia	...	-25.6%	...	-6.5%	25.4%	21.8%
Central Serbia	...	-24.5%	...	-3.2%	25.1%	24.2%
Vojvodina	...	-28.2%	...	-13.8%	26.1%	16.4%
Average Wage - DM	107	-31.7%	...	...	...	...
Montenegro	154	-14.1%	191	1.1%	16.2%	9.1%
Serbia	102	-33.8%	93	2.3%	-8.1%	-23.8%
Unemployment Rate^{b)}	27.3%	8.3%	...	...	...	...
Montenegro	36.8%	7.9%	...	...	...	...
Serbia	26.5%	8.2%	...	...	...	...
Export - USD million	1,498	-46.9%	151	-5.7%	20.6%	15.6%
Montenegro	123	-4.7%	15	-14.0%	62.9%	51.6%
Serbia	1,375	-48.9%	136	-4.7%	17.3%	12.3%
Import - USD million	3,296	-30.3%	242	-22.6%	-6.2%	31.4%
Montenegro	358	6.9%	20	-30.2%	-32.5%	1.9%
Serbia	2,938	-33.2%	223	-21.8%	-2.8%	35.7%
Monetary supply (M1), end of period, DIN billion	16.4	51.9%	22.5	2.3%	69.1%	56.0%
Cash	6.7	34.0%	8.0	6.7%	48.6%	29.9%
Deposits	9.7	67.2%	14.5	0.0%	83.0%	74.7%
Real money supply, end of period, DM million	739	-42.3%	838	1.6%	-24.8%	-37.6%
Market exchange rate, monthly level	4.25%	-38.8%	6.33%	8.6%	187.7%	24.1%
Retail prices	...	42.4%	...	2.9%	68.4%	58.7%
Montenegro	...	60.1%	...	2.0%	157.1%	141.6%
Serbia	...	41.1%	...	2.9%	62.7%	53.4%
Cost of living	...	44.9%	...	2.9%	76.0%	66.2%
Montenegro	...	67.2%	...	1.3%	163.3%	151.2%
Serbia	...	43.5%	...	3.2%	70.2%	60.0%
Industrial prices	...	44.2%	...	...	...	...
Montenegro	...	63.7%	...	...	...	...
Serbia	...	43.2%	...	...	...	...
Black market exchange rate (din/DM)	12.6	88.1%	23.7	2.8%	109.8%	124.9%

^{a)} G17 estimate based on official information from the Federal Statistics Office

^{b)} The unemployment rate for VI 2000 is 27.5% in Serbia, 40.2% in Montenegro, & 28.5% in FRY

What was the regime thinking?

Why, then, were early presidential elections scheduled? According to one theory the answer is in the very nature of Slobodan Milošević. The opposition questioned his authority and made him very nervous. He then accepted a challenge and replied to the opposition - you wanted early elections, you will have them, but with a much more serious opponent. Indeed, the regime did everything to secure its victory in federal elections by amending the constitution and electoral laws so as to enable it to control presidential elections. Under a second theory, the government monitors everyone, but monitors its members the most. It is aware of the dissatisfaction within the Socialist Party (SPS), jointly pressed by the Radical Party (SRS) and the Yugoslav Left (JUL). As the SPS can no longer count on the unlimited loyalty of its members, it was necessary to opt for a direct election of the president of the FRY. A third theory argues that the regime did all it could to divide the opposition so that it entered the elections with two lists. This is an ideal position for the SPS, still the strongest single political party. As such, tying presidential to federal elections should have secured the re-election of the hitherto president with the slightest of risks. A fourth theory claims that it is a miscalculation. Nobody in the ruling coalition believed an opponent would arise that could offer a credible political alternative to the current president of the FRY. If there is no alternative, the risk is minimal. A fifth theory asserts that Slobodan Milošević wants to convey a message to the international community - both to that part he is in conflict with and to that one he expects support from. He hopes to project that he is the sole representative of Yugoslavia to enjoy popular support, and that sooner or later the international community has to accept this reality, despite the indictment of the Hague Tribunal and the Montenegrin authorities' protests. Hence, there are many theories and very few facts. But even those few facts prove that Slobodan Milošević is likely to lose his office.

Is this a reason for panic in the ruling coalition? Not yet. It has already managed to secure around 50 seats in the lower Chamber of Citizens of the Federal Assembly, toward the 70 seats required for a majority. It has also gained control in the upper Chamber of Republics. This is a consequence of the boycott of elections by the ruling coalition in Montenegro and the inclusion of fictional Serbian and Albanian votes from Kosovo (which could also be dispatched by mail). Even in the case of a drastic defeat of the regime in Vojvodina and Serbia proper, there still remains the delusion that the majority in the Federal Assembly is preserved. On the other hand, two opposition lists at local elections dramatically reduce the democratic opposition's prospects of remaining in power in the towns and municipalities it now holds. If the voter turnout does not exceed 70 per cent, there will certainly be a second round of elections for the president of the FRY. In that case the ruling coalition can look for an opportunity in election fatigue among the opposition voters. However, if the voters' response remains high in the second round, Vojislav Koštunica will be elected the new president of the FRY. The ruling coalition will then be panic-stricken. This would be an important step towards changing the whole system of power in Serbia.

Presidential elections, therefore, depend on voters' motivation for going to elections, as the majority of citizens would be pleased to vote against the existing president of the FRY. On the other hand, the situation with federal parliamentary elections is completely different. The election of the federal parliament is based upon manipulation that gives the regime an incomparable advantage. The opposition is certainly aware of this fact, but is likely participating so as to avoid any confusion within the electorate. The fate of local elections is still undecided. If the opposition succeeds in forming a sort of coalition at the last moment, including a technical one, i.e. if it does not compete mutually, then there will be no major changes. If not, one should be prepared for great surprises.

In any case, these elections will serve as an important link in a peaceful transition of power, but they will not be fatal to the regime, as is often claimed by the press. Of course, the prospects of the country will appear much better should democracy win, but it is important to know that even if these elections end in a tie, they will contribute towards a final victory - at the next republican elections.

Two halves to electoral victory

It would be unwise for the results of these elections to be judged only by emotions and the orientation of political parties. Great and unrealistic expectations always trigger huge disappointment and apathy after elections. This used to be a vital mechanism for the continuance of the regime and the creation of an impression that it is irreplaceable. It is important to recognize that this is an electoral game consisting of a first and a second half. The prospects of winning in the first half are both great and realistic. The victory of Vojislav Koštunica is quite possible. We should not forget that in the accepted electoral system his opponent has a huge advantage. However, the final result depends on whether the DOS (Democratic Opposition of Serbia) and the SPO (Serbian Renewal Movement) will manage to find common ground at the local elections in the last moment. A majority of the SPO's local organizations are not corrupted and do not support the collaboration of the party's elite with the regime. This fact should be taken into account to form a winning coalition for local elections.

What can the international community do? The best thing would be to do nothing during the next month or so! The worst thing it could do would be to oust Yugoslavia from the UN or to engage in forceful attempts at arresting someone from the list of those indicted for war crimes (recall the case of Krajišnik's arrest just prior to elections in Republika Srpska). With pompous media coverage of the opening the Varadin bridge and the ordered visit of the Russian Patriarch on the very eve of elections, this would further strengthen patriotic sentiments and voters' hostility towards the international community. Moreover, it would alter the main theme of the elections - a referendum against Milošević. Not much wisdom is required to assume that the regime would use this opportunity for the benefit of its propaganda about the country's defense, national consciousness and the opposition's betrayal. If the international community is not ready to undertake any positive measure in the interest of the citizens of Serbia, it can easily wait another month. There is always plenty of time for bad news.

Formal and political winners at these elections need not be the same. It is quite certain that there will be great electoral fraud in Montenegro and Kosovo. In an extreme case such fraud can reach a million votes, which makes over 15 per cent of the electorate. Electoral fraud will probably not reach such dramatic proportions. Yet, one should count on the theft of 5-10 per cent. Thus, monitoring of the elections and massive voter turnout are necessary to neutralize this effect. On the other hand, the opposition in Serbia must react politically and even now begin to think about next year's elections for the Assembly of the Republic of Serbia, wherein the real power rests. It should acknowledge the results of these elections only on the basis of the political will of the electorate in Vojvodina and Serbia proper. Anything else is unimportant for a change of power in Serbia.

Voter turnout will determine elections

An important link to peaceful transition

Two lists threaten opposition governments in municipalities

The international community can help the most by doing nothing

A Program for Fiscal Reform

Quick or Sustainable Stabilization?

In the last decade we had two hyperinflations and two stabilization programs. Both of them (Ante Marković in 1990 and Dragoslav Avramović in 1994) focused on quick, but unsustainable stabilization. Hence, they were relatively successful on their own terms. Both programs resulted in the stabilization of prices, but soon afterwards market instability and inflation returned.

It might have been impossible to achieve permanent stabilization, taking into account the unfavourable political climate. We assume that a new reformist government would be formed on the basis of a new political environment and that it will not face that element of the problem. However, there will be a dilemma over whether to go for quick results in macroeconomic stability, and take the risk that they could be short-lived, or to undertake all the necessary and often unpopular measures which will provide lasting economic stability.

This time everything should be done to bring lasting stability to prices. Thus, it is first necessary to clearly indicate the fundamental sources of instability in the Serbian economy and to look for solutions in cooperation with the international community.

**Sustainable price
stabilization**

Where should we begin?

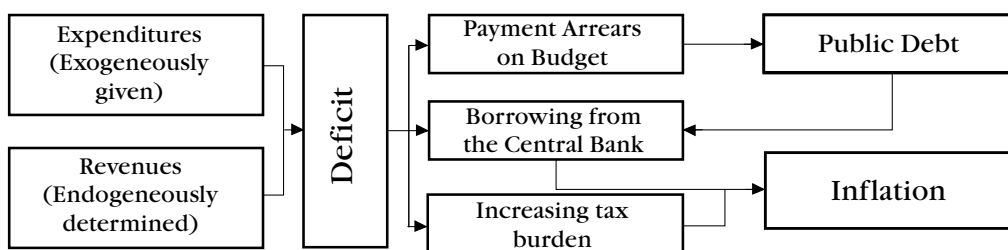
Quick stabilization can either be exchange rate or money based. The choice between the two options will, among other things, be the result of initial market conditions. Namely, in a situation marked by high price instability with full dollarization, the chances to implement a form of exchange rate based stabilization program are greater. On the other hand, in a situation of high inflation, but not hyperinflation, it is possible to implement the stabilization program with the supply of money serving as a nominal anchor.

In any case it is necessary to give priority to redressing the fiscal deficit. The fiscal deficit is the most difficult political and economic issue in the country and its solution will determine the outcome of the whole stabilization program. The above-mentioned stabilization programs of 1990 and 1994 both faltered on exactly that issue. In addition, the hyperinflation of 1992-93 was the result of fiscal deficit monetization. The fiscal deficit is expected to be the fundamental problem for the new reformist government as well.

**Fiscal deficit is the
most difficult
question**

Financing the Fiscal Deficit

The fiscal deficit is currently financed as shown in the figure below. The state first drafts its expenditures and commits itself to financing the army or pensions in specific amounts or to maintaining the low prices in public enterprises (for example, electric power or petrol prices). Tax rates are determined subsequently. The tax base is predominantly related to the salaries of those employed in the private economy and social services. The tax burden of net wages currently exceeds 100 per cent.



As fiscal revenues are insufficient to cover all expenditures there is a deficit financed either by borrowing directly from the NBY or indirectly through banks. For example, the debt of the pension fund towards pensioners was repaid in 1999 in the form of power coupons. However, the Power Company of Serbia was financed through the obligatory allocation of banks' investment and a base money issue. For example, all banks are bound to have obligatory reserves amounting to 17% and to keep them in the form of the NBY securities, along with an additional 7% in the securities of the Federation and 6% of obligatory reserves in the Serbian Power Company's securities. Hence, the banking system has practically repaid the state debt to pensioners. As the banks are illiquid, they have borrowed from the NBY to finance these reserves. Unfortunately, the whole operation has thereby been reduced to a NBY money issue.

The remaining deficit is simply not financed, but is converted into state debt to pensioners, employees of state services, schoolteachers, university lecturers, etc. As the affected groups of the population keep pressuring the state, sooner or later it will have to service its public debt by borrowing from the NBY.

From time to time new taxes are introduced, such as an additional turnover tax and duties for financing the country's defence in the year 2000.

This method of fiscal deficit financing leads directly or indirectly to inflation. The current regime of price controls does not exclude inflation, but only temporarily suppresses and postpones it.

Rescheduling Internal Debt

A law on the rescheduling of state debts to the NBY was passed at the end of the last year. All these debts were based on the approval of short-term credits from the base money issue and were due for repayment by the end of the current year. However, that schedule was not met and now these short-term debts have been transformed into long-term debt.

Financing the Fiscal and Quasi Fiscal Deficit by Issuing Base Money (DM millions)

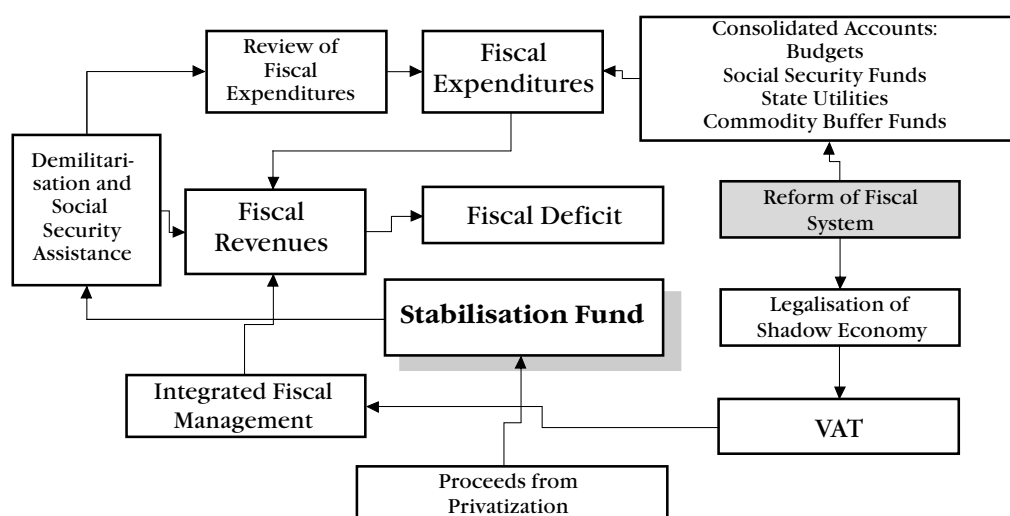
	Budgets			Commodity reserves		Pension funds		Total
	FRY	Serbia	Montenegro	Serbia	Montenegro	Serbia	Montenegro	
1994	0	196.8	24.7	226.3	13.5	0	0	460.3
1995	0	0	0	0	0	0	0	0
1996								0
1997	0	9.9	0.9	20.8	0	159.8	7.2	198.6
1998	0	42.6	0	0	0	81.2	8.2	132.0
1999	39.2	0	0	0	0	22.6	0	61.8
Total	39.2	248.3	25.6	247.1	13.5	263.6	15.4	852.7

The above table shows the debt in dinars converted into foreign currency on the basis of the black market exchange rate at the end of the year in which the credit had been approved. The total debt exceeds the value of the money supply at the end of 1999, also expressed in German marks at the black market exchange rate. It demonstrates the significance of financing the fiscal deficit by issuing money.

Balancing the Budget

A well-balanced budget should be the new government's goal. It is, however, impossible to achieve in the first year. Fiscal obligations are large and fiscal revenues are very limited. If taxes were raised to a level enabling fiscal revenues to cover all fiscal expenditures, the burden on the economy would increase dramatically, leaving no funds for private investment financing. This would secure stability, but at the cost of reducing the level of economic activity, low as it is, still further. As the unemployment rate is exceptionally high, such stability would not be sustainable. In addition, political pressures on a new reform government should be taken into account. Citizens will expect prompt improvements in their living standard and a drop in the unemployment rate, not a tax increase and a drop in income.

It is impossible to balance the budget in the first year



Instead, what should be done is to follow the example of what the authorities did in 1997 when they sold 49% of Telecom Serbia in a relatively short period. There is another part of this company and some other companies that are also ready for sale, and potential international investors have already been identified. Unlike in 1997 these proceeds should be used for macroeconomic stabilization.

On the fiscal side, a stabilization fund should be established to cover budgetary deficits in pension funds and for restructuring the army and the police. The suggestion made by Dragoslav Avramović to support the pensioners whose incomes are below the minimal living standard is justified both from humanitarian and fiscal perspectives, as it buys time to assess the efficiency of the whole retirement insurance system. Furthermore, a program should be introduced to support stability in the region based on demilitarizing a part of the Yugoslav army and police forces. This program will cost a lot, but will lead to a much higher reduction of public (military) expenditures in a later stage.

Reform the System of Fiscal Management

Fiscal reform must include the creation of a consolidated balance of public finances and the introduction of a treasury as a new institution for the improved management of public revenues and expenditures.

A consolidated balance of public finances is necessary because of the federal and decentralized budget systems (federation, two republics, two, but actually, one province and about 200 towns and municipalities). There are also many quasi-fiscal institutions such as pension and other social security funds, state enterprises and commodity reserve funds. Fiscal and quasi-fiscal accounts should be pegged together and their mutual debts should be excluded in order to determine the amount of the public deficit in a transparent manner.

At this moment these accounts are not connected, and there is no clear evidence of public expenditures or coordinated management of the state budget or of the various funds' liquidity. Hence, there are problems with liquidity, which are currently resolved through increased borrowing from the NBY or by increasing unpaid obligations, rather than through the better management of state revenues and expenditures.

Another set of measures relates to the legalization of the shadow economy, which comprises 25-35% of GDP, according to some estimates. By enabling easy business registration and modest tax payments, a significant portion of the shadow economy would be transferred into legal channels of trade and production. Parallel to that, the value-added tax should be introduced along with the complete array of accompanying documentation to drastically reduce tax evasion and activities in the shadow zone. Further, the collection of personal income tax should be more strictly enforced.

The institution of a treasury is the most important novelty in a new consolidated management of public revenues and expenditures. It rules out the creation of extra budgetary revenues or bringing fiscal decisions without parliamentary oversight. In that manner the whole fiscal process becomes more transparent and is thereby less prone to corruption.

Revise Fiscal Expenditures

Naturally, a reassessment of the current fiscal expenditures is also necessary. Certain savings are also possible. However, the real level of incomes in the sectors of education, health, and state services is so low that large savings are almost impossible.

There are two groups of fiscal expenditures that deserve special attention. The first are military and police expenditures. At their current level they exceed the usual European standards. It would be naive to believe that they can simply be reduced to a sustainable level overnight. After ten years of wars and conflicts in the former Yugoslavia there is a huge police and army apparatus. Redundancies cannot simply be thrown out in order to eliminate the fiscal deficit. There are strong practical restraints on that policy. One must think about the establishment of a separate fund for restructuring the police and the army. Redundant workers should be offered re-qualification and an opportunity to find other employment.

The second group of quasi-fiscal deficits is related to the financing of pensions. The ratio between pensioners and employed is far more unfavorable in Yugoslavia than in other countries. Minimal pensions cannot guarantee the existential minimum. Every government should be extremely sensitive to the problems of pensioners. Moreover, the new government would not gain voters' support unless it had a plan of urgent assistance to the pension funds. The permanent problem of the pension system can be resolved only through its reconstruction in cooperation with the World Bank and with an overall economic recovery. However, something has to be done in the first year of the new reformist government so as to leave it the maneuvering space to solve other important tasks.

Return Frozen Currency Savings

To meet its obligations for the repayment of frozen foreign currency savings, the state (the federation, the two republics and the NBY) must pay DEM 6.36 billion over the next 12 years. Because of the NATO bombing the servicing of these obligations was delayed, amounting to DEM 128 million last year. These obligations amount to DEM 286 millions this year. This means that the servicing of frozen foreign currency savings will significantly burden all budgets.

On the other hand, there will be no renewal of public confidence in the banking system unless this issue is resolved in a satisfactory manner. In addition to the state, the banks themselves are obliged to pay another DEM 1.122 billion.

The law permits the sale of state property (business premises) and the appropriation of 25% of privatization proceeds to service the frozen foreign currency savings. One should insist upon these sources of financing in the future, as well as upon the replacement of foreign currency deposits with securities that could be publicly traded even before their date of maturity.

Improve the management of public accounts

Legalize the gray economy

Reconstruct the pension system

MACROECONOMIC REVIEW

Ljubomir Madžar

The reliability of official economic indicators is collapsing

Prices

The downward tendency of officially expressed price growth and living costs' indices continued in July. Retail prices grew by 2.9%, after registering growth of 5.2% and 4.2% in May and June. Living costs increased at the same rate, 2.9%, while they were up in the two previous months by 5.7% and 3.9%. The three-month downward tendency of the growth in retail prices' and living costs' has followed a long upward tendency in price growth rates. This must be considered with great reserve given the forthcoming elections, but also regardless of them. Manipulation of statistical data has become part of a widely diversified range of other, richly differentiated manipulations. That producer prices' indices have not been published in the last several months suggests they may show a large deviance from retail price and living costs' indices – a fact that has become apparent even to laymen. The National Bank of Yugoslavia's failure to published facts on the amount of money in circulation, and the Payment Service's failure to published facts on the income of the population, are equally indicative of the collapsing reliability of official economic indicators.

Price control is a second fact of importance. Due to control, officially registered inflation is smaller than that which would be derived from the free interaction of market forces. However, control results in accumulating and growing inflationary pressures that incite various forms of suppressed and hidden inflation. Unabsorbed by the market, the inner distortion transfers into overall shortages and the field of foreign trade where it manifests itself in a large deficit. Due to the modification of statistics and price control, total price growth in this year is considerably lower than what could have been expected. In July of this year relative to December of last year, retail prices grew by 23.0% and living costs were up by 24.6%, while year on year, retail prices grew by 58.4% and living costs by 76.0%.

Comparing data that relate to different intervals reveals the persistence of inflation, deeply-rooted in the very fundamentals of the Yugoslav economy. Thus prices in the first seven months of the year 2000 grew by 40.8% relative to their average growth in 1999, while compared to the same period of last year they grew by 58.7%. However, the level of retail prices in July rose year on year by a whole 68.4%. An analogous configuration of growth rates is expressed with living costs as well.

The constellation of officially presented inflation rates is interesting and highly suggestive. Because it introduced a dual-currency system, Montenegro faced serious difficulties in adapting and administering a totally unconventional transition regime. Despite the introduction of the DEM as a parallel currency, the first months brought remarkably high inflation rates. For example, retail prices in Montenegro were up by 141.6% in the first 7 months of this year relative to the same period last year, while in Serbia retail prices were up "only" 54.3%. Initial adaptations are at their end and no longer produce significant inflation. Montenegro has a smaller chain price growth rate month on month than Serbia: 2.9% in Serbia for retail prices, 2.0% in Montenegro. For living costs the corresponding rates are 3.2% and 1.3%.

Production

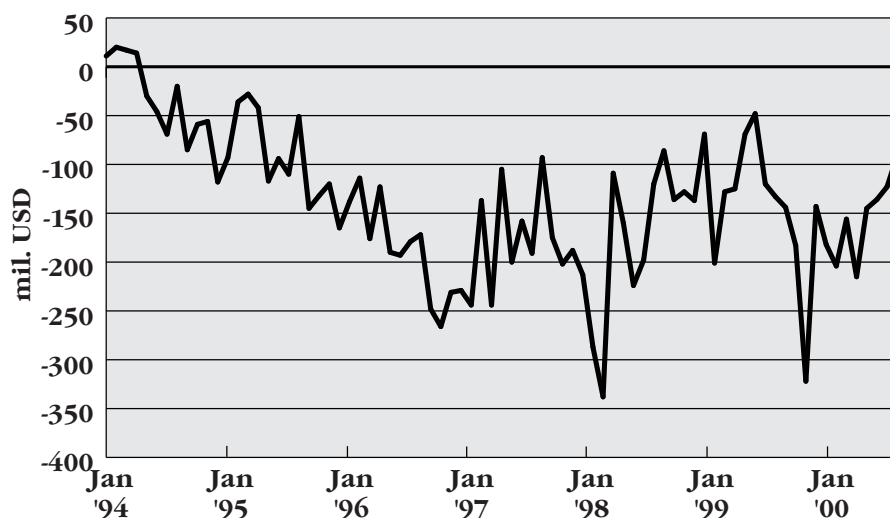
Production indices, when observed out of a wide time and development context, depict the usual image of very dynamic growth. In the first seven months of this year, the index of the total scope of industrial production was up by 20% year on year. The monthly index is even more impressive - only at first glance - as in July it was 24.3% over the level of July 1999. It has become reprehensible, but not redundant in the least, to pinpoint that the "secret" of such high growth indicators is contained in an extremely low basis resulting from the bombing and concomitant paralysis of economy. When an average index for the whole of 1999 is taken into account, it reveals a downward tendency that is illustrative of a basic and determinative downward trend beginning in mid-1998. Calculated in this way, the industrial production index amounts to 110.8 for the first seven months of this year, and 106.8 for July (1999 average=100).

A series of deseasoned indices (1999 average=100) illustrates the same phenomenon in a slightly different way, showing industrial production growth in the first four months of 2000, and stagnation at the level of around 120% since that time. The deseasoned index for July shows a certain decrease relative to June, falling from 120.5 to 120.3%. This picture is supplemented and highlighted by noting that industrial production in July fell by 5.3% month on month. As for industrial sectors, i.e. among the eight groups of industrial branches depicted in official statistics, it can be noted that electric power, steel-production and some other industrial sectors register above-average growth. The production of food and tobacco registered the lowest index (79.2%), followed by textile, leather and rubber

production, and the metal-processing and electric power industries (the corresponding indices are 87.5 and 87.9). The latter index is somewhat surprising with regard to the widely publicized reconstruction campaign, which should have - if it really moves a great amount of resources, and with the positive and notorious balance of payment restrictions in mind - strongly incited production especially in this sector.

There are significant differences between industrial production indices for Serbia and Montenegro. When the first seven months of 2000 are observed and compared to the same period in 1999, the Montenegrin index is a lot less than the one for Serbia - 101.0 to 121.8. This would, on one hand, illustrate the potential that Montenegrin industrial complexes suffered less damage during the NATO bombing than Serbian ones (that hypothesis would require proof), while on the other hand it could also indicate the effects of the Serbian economic blockade towards Montenegro. It is interesting, however, that the current index for Montenegro (July : June 2000) is much larger: 114.4 which denotes much livelier current industrial growth dynamics than that of Serbia, whose index of 93.5 is taking on regressive traits

FRY Balance of Trade



Foreign trade flows

The most conspicuous characteristic of Yugoslav foreign trade is the enormous foreign trade deficit. That deficit has constantly piled up over the past ten years, with the coverage of exports by imports typically moving at around one half. According to conservative estimates, in this troublesome and turbulent decade the accumulated trade deficit has reached some 15 billion USD. How the deficit was covered was long considered to be a sort of unsolvable mystery. Even a corresponding neologism was assigned - unidentifiable financial sources. The mystery is gradually resolved and now it is clear that the population's foreign currency reserves represent the main source for financing the deficit. Households (are forced to) supplement their expenditure by activating foreign currency savings. It is only natural that this kind of a financial source results in a large surplus of imports over exports. Further, export revenues are not fully registered and a large portion does not even enter the country. The enormous discrepancy between market and official foreign currency exchange rates can hardly result in any enthusiasm, or discipline, with regard to repatriating foreign currency.

Movements registered during the first seven months of this year dramatically illustrate and confirm the deep-rooted and structurally conditioned discrepancy between import and export. Export grew by 15.6% January to July relative to the first seven months of the previous year. Import growth is much greater and amounted to 31.4% in the first seven months year on year. Both indices reflect the extremely low basis of last year, but their difference is indicative and forewarning. Imports amounted to 2,203 million USD in the same period, while exports amounted to only 986 million USD. Regarding the scope of exchange, the trade deficit registered at an unusually high level of 1,217 million USD. Coverage of imports by exports fell well below one half and remained at a level of only 44.8%. Although similar to those for Yugoslavia, figures for Serbia are slightly worse. In the observed seven-month period, imports reached 1,986 million USD, exports reached 877 million USD, and the corresponding deficit was 1,109 million USD. Coverage of imports by exports fell to 44.2%. Compared to the corresponding period last year, imports increased by 35.7% and exports increased by 12.3%. During that time interval, Montenegro exported 109 million USD worth of commodities, and imported 217 million USD worth. Exports covered imports by 50.2%. Monthly figures are a bit more favorable than the considered seven-month sums. In July, FRY exports amounted to 151 million USD (growth of 20.6%), while imports amounted to 242 million USD (decline of 6.2%). The coverage of imports by exports rose to 62.4% in July. Apart from usual short-term fluctuations, the shortage of foreign currency for paying imports could have contributed to this result.

In the past year the market foreign currency exchange rate grew much faster than both retail prices and living costs. Relative to July 1999, the market rate increased by 109.8%, while retail prices grew by 68.4%, and living costs grew by 76.0% in the same period. Observed through the market exchange rate, the dinar has depreciated notably as compared to the year before. The same can be said with an independent observation of July, when the market exchange rate increased by 2.9% while officially registered living costs and retail prices grew by 2.8%. It can thereby be concluded that July brought additional depreciation.

Monetary policy

Yugoslavia has been functioning on a dual currency system for quite a while. There is no essential difference between Serbia and Montenegro in that respect. The only difference is that Montenegro has made this obvious fact of life official, while Serbia has not (yet). Differences connected to the official status of the German mark are not wide in character, and it can be maintained that the unity of the Yugoslav monetary system has not been disrupted in principle.

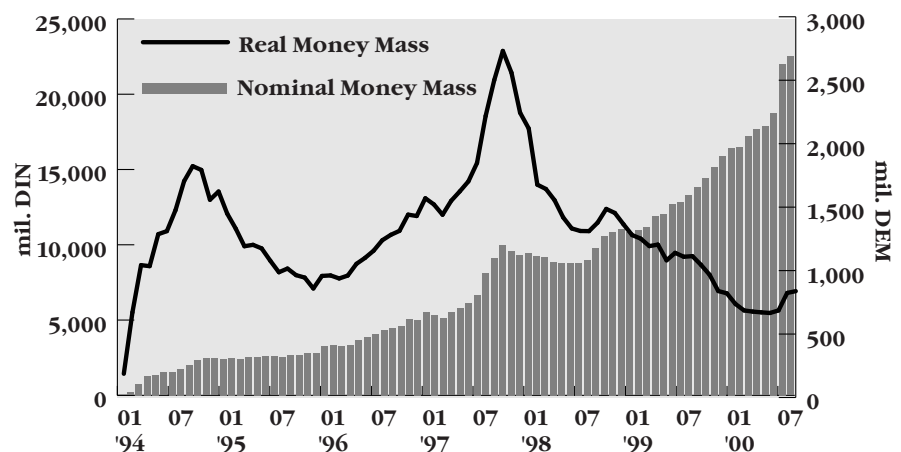
Estimates of household foreign currency reserves move within the wide scope of 2 to 7 billion DEM. The quantity of that large reserve of wealth that becomes activated in transactions and adds to the money mass, as well as the passive part of it that households guard for unpredictable and urgent needs or for planned financing of large transactions remains unknown and cannot be discovered. This is the reason behind why official data on the (dinar) money mass cannot be interpreted as a measure of liquidity in the economy and especially not as a measure of liquidity in society as a whole.

All this stands for both households and the part of economy that disposes of hidden foreign currency reserves. Due to the defective, collectivistic-formed basis of property, means from both the social and state sector are undergoing intensive erosion. The state and social part of the economy leaks liquidity on all sides and ever since the long gone times of self-management it has been insolvent. The money mass reached an amazing 22.5 billion dinars by the end of July, with an impressive 8 billion dinars (35.6%) of cash. The market exchange rate for July was estimated at 23.7 dinars in the Economic Review, suggesting almost 950 million DEM worth of money mass. This is an extremely low level of monetization by international standards.

Monetary policy remains in a position that is so typically described in Greek tragedy: either the economy gets permeated by additional credits at the cost of surging already dangerous inflationary tendencies, or credit taps dry out in an attempt to defend the dinar, producing a total obstruction of economic activity in many segments due to a shortages of money to cover the next production cycle. Recently the crisis got worse even while the money mass grew rapidly. Namely, uncontrolled issue increased the amount of money from 18.7 billion dinars in May to 22.5 billion in July, or a whole 20.3%. The annual equivalent for this two-month rate is no less than 203.4%, which surpasses all permissible limits and is a rare occurrence in the international environment, but strongly reflects the destructive chaos into which the whole of our economic policy has hopelessly fallen.

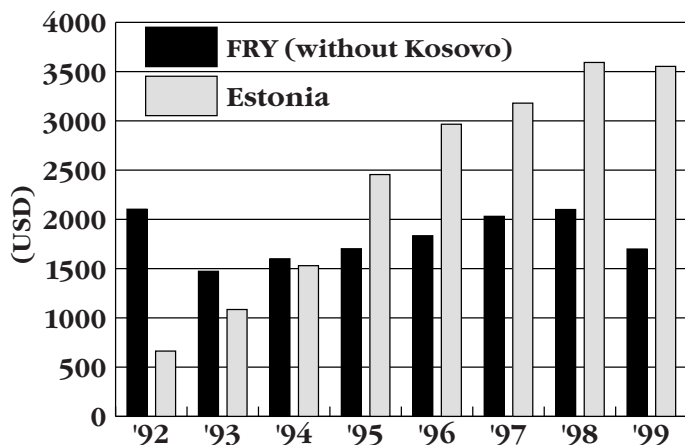
**Yugoslavia's
monetary unity has
not been disrupted
in principle**

Money Mass

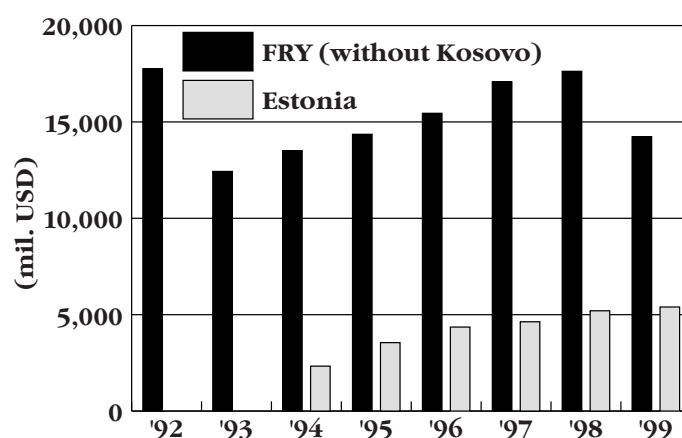


Yugoslavia in the mirror of Eastern Europe

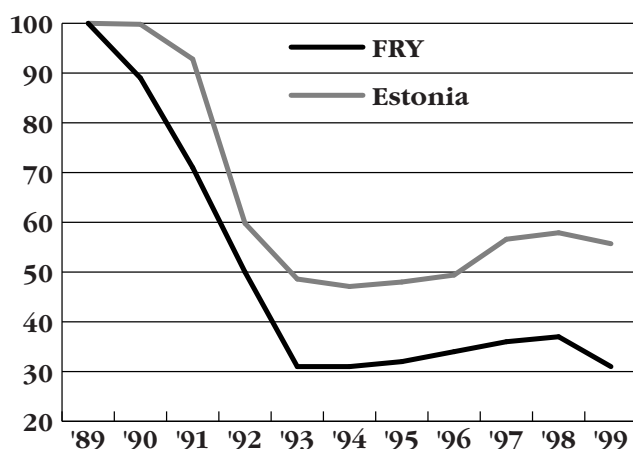
GDP



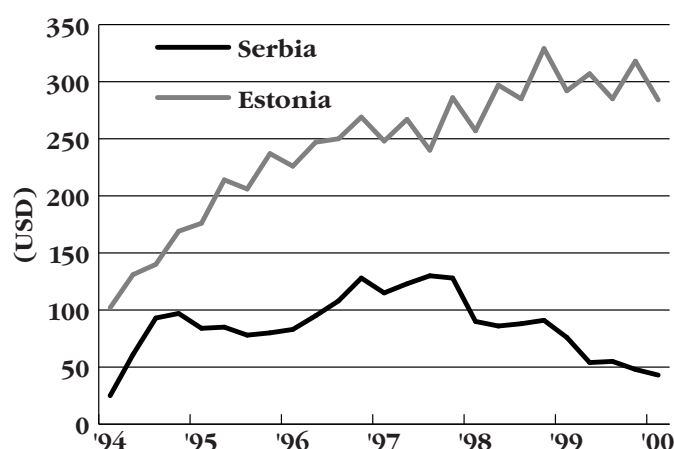
GDP per capita



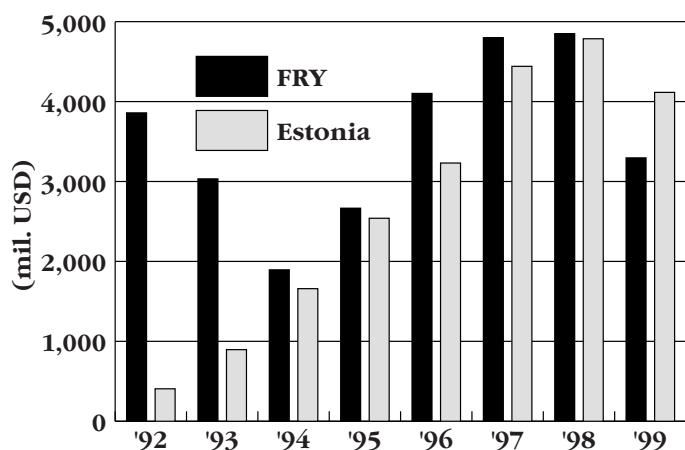
*Industrial Production
1989 = 100*



*Salaries
Quarterly Averages*



Import



Export

